

## 1999 Country Reports on Economic Policy and Trade Practices

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### PARAGUAY

#### Key Economic Indicators

(Millions of U.S. Dollars unless otherwise indicated)

	1997	1998	1999 1/
<i>Income, Production, and Employment:</i>			
Nominal GDP 2/	9,607	8,594	7,854
Real GDP Growth (pct)	2.6	-0.5	-1.0
GDP by Sector (pct):			
Agriculture	27	27	28
Manufacturing	14	14	14
Services	37	37	36
Government	6.0	6.0	5.0
Per Capita GDP (1982 US\$)	1,634	1,585	1,553
Labor Force (000s)	N/A	N/A	N/A
Unemployment Rate (pct)	6.9	7.2	7.2
Underemployment Rate (pct)	18.1	21.4	22
<i>Money and Prices (annual percentage growth):</i>			
Money Supply Growth (M2)	7.7	-4.7	12.1
Consumer Price Inflation (pct)	6.2	14.6	7.0
Exchange Rate (GS/US\$ Year End)	2,294	2,830	3,310
Official	N/A	N/A	N/A
Parallel	N/A	N/A	N/A
<i>Balance of Payments and Trade:</i>			
Total Exports FOB 3/	3,980	3,824	2,714
Exports to U.S. 3/	40.6	38.7	1/
Total Imports CIF 3/	4,186	3,938	2,801
Imports from U.S. 3/	913	734	1/
Trade Balance 3/	-207	-114	-87
Balance with U.S. 3/	-872	-695	1/
External Public Debt	1,437	1,475	2,108
Fiscal Deficit/GDP (pct)	-0.8	-1.2	N/D
Current Account Deficit/GDP (pct)	-5.0	-2.7	-0.9
Debt Service Payments/GDP (pct)	17	19	3.8
Gold and Foreign Exchange Reserves	846	875	1,006
Aid from U.S.	4.8	2.2	3.0

1/ 1999 figures are central bank preliminary data except for U.S. imports and exports, which are taken from U.S. Department of Commerce Trade Statistics.

2/ Percentage changes calculated in local currency.

3/ Merchandise trade.

4/ External and internal public debt only. Private external debt to GDP share not yet available

### *1. General Policy Framework*

Over the last decade, Paraguay's economic policy framework has encouraged the re-export trade to Brazil and Argentina and provided tax and regulatory advantages as well as soft loans to non-competitive local industries. In agriculture, the government has continued non-transparent state-run cotton programs for small farmers and kept hands off large-scale private sector oil seed production, the leading source of hard currency from exports. Government investment has shrunk as spending on debt service and government salaries to provide political patronage drain government revenue.

Paraguay's economy is currently in recession, and growth has been weak since 1995. The GDP contracted 0.5 (one half) percent in 1998 and will likely contract at least an additional one percent in 1999. Until the mid-1990s, Paraguay largely avoided deficit spending and kept foreign debt at a manageable level. Government spending as a percentage of GDP began to increase earlier in the decade, but deficits were avoided due to revenue windfalls from taxes and tariffs on imports from the re-export trade. This windfall was not productively invested, but rather spent to swell already bloated government payrolls.

The Central Bank under the Cubas administration (August 1998 - March 1999) kept interest rates high on guarani-based bonds sold to private banks, limiting liquidity and keeping exchange rate pressures off the guarani. In an effort to stimulate the economy, the Gonzalez Macchi government has lowered interest rates from 29 to 13.5 percent between May and November of 1999. A series of banking failures and political instability over the last several years has led investors to move to dollar-based deposits and loans. A higher than expected five percent increase in guarani-based deposits between August and September of 1999 may indicate that the central bank is printing money as a response to growing revenue shortfalls, which stem from a deepening recession and a moribund re-export trade. The Paraguayan government is heavily dependent on tariff revenue, which will continue to shrink in the near future as Mercosur adjusts its common external tariff rate down from an average of 23 percent in 1999 to 15 percent in 2006.

Paraguay's membership in Mercosur offers important opportunities. Efforts to improve weak infrastructure, especially in power transmission and distribution, telecommunications, road, river, and civil aviation systems, potable water, and sewage treatment, provide potential markets for United States' goods and services.

## *2. Exchange Rate Policy*

All foreign exchange transactions are settled at the daily free market rate. The central bank practices a dirty float, with periodic interventions aimed at stabilizing the guarani. These interventions have become more frequent, with the central bank selling \$295 million in the first seven months of 1999. In the twelve months leading up to November, the guarani depreciated by 17 percent against the dollar. On November 15, the market rate stood at 3,330 guaranies to the dollar. Historically, the central bank accelerates the devaluation of the guarani in June and July by slowing the sale of dollars or purchasing dollars on the open market to help trigger the repatriation of foreign reserves from international sales of the cotton and soybean harvested in the first half of the year. It is legal to hold savings accounts in foreign currency, and in October 1994 a decree was promulgated that legalized contractual obligations in foreign currencies. With a lingering recession, the failure of many local banks, and exchange rate uncertainty, the dollar has become the preferred unit for large purchases, savings, and virtually all international transactions. Sixty-four percent of all funds in Paraguayan savings accounts are in dollar-based accounts as of September, 1999.

## *3. Structural Policies*

Consumer prices are generally determined by supply and demand, except for public sector utility rates (water, electricity, telephone), petroleum products, pharmaceutical products and public transportation fares. The Ministry of Finance oversees all tax matters. Under current law, corporate incomes are subject to a 30 percent tax rate. There is no personal income tax. As an incentive to investment, the tax rate on reinvested profits is 10 percent. The existing Investment Promotion Law (law 60/90) includes complete exemption from start-up taxes and customs duties on imports of capital goods. There is a 95 percent corporate income tax exemption for five years on the income generated directly from the GOP approved investment. The Ministry of Finance, at the urging of the IMF, is currently studying the elimination a variety of tax breaks, including law 60/90, to help balance the budget. The government implemented a value-added tax (IVA) in 1992. Some analysts have estimated that IVA compliance hovers around 30 percent. Charges of corruption among tax officials are endemic. Nearly half of all tax revenues are collected at customs on imported merchandise. Agriculture makes up nearly 25 percent of GDP, but contributes less than one percent of government revenue. Even though land taxes are low, chaotic land title records makes land tax evasion the norm.

## *4. Debt Management Policies*

In 1992, the government reduced external debt with both official and commercial creditors through a drawdown of foreign reserves. Since that time, however, increasingly large public deficits have nudged public debt back upward. Foreign reserves dwindled to \$652 million by the end of June 1999. A \$400 million loan from Taiwan in July temporarily bolstered reserves, which at the end of September stood at \$1.004 billion. The government's debt at the end of September 1999 totaled \$2.044 billion. Paraguay owes \$1.044 billion to multilateral lending

institutions, \$987 million to foreign governments and \$13 million to private foreign banks. Last year, a visiting representative from the World Bank announced that no new World Bank loans would be available to Paraguay until it allocated and properly accounted for existing loans. Paraguay continues to meet its obligations to foreign creditors in a timely fashion.

## *5. Aid*

Direct U.S. aid to Paraguay in fiscal year 1999 included roughly \$918,000 in military assistance administered at post, such as international military education and training, information exchange visits and seminars; \$228,000 in counter-narcotics assistance; and \$6 million in USAID disbursements for democracy, reproductive health and biodiversity protection. Indirect U.S. contributions via the Inter-American Development Bank, World Bank and United Nations programs totaled tens of millions of dollars more.

## *6. Significant Barriers to U.S. Exports*

Paraguay is a member of the World Trade Organization (WTO) and has a relatively open market that does not require import licenses, except for used clothing (see below), guns and ammunition. However, the United States prohibits the export of U.S. guns and ammunition to Paraguay. U.S. companies have not fared well in non-transparent government procurement tenders. Paraguayan regulations require country of origin designation on domestic and imported products. Expiration dates are required for medical products and some consumer goods. As of January 1998, imported beer is required to display detailed manufacture and content information, labeled in Spanish at the point of bottling. A similar regulation was put in place for shoes, clothing, packaged food, and other consumer products. However, labeling of imported goods at distribution centers within Paraguay is still commonplace. MERCOSUR-wide labeling requirements are currently being developed.

Law 194/93 established the legal regime between foreign companies and their Paraguayan representatives and has been described by executives of U.S. companies represented by local firms as increasing the risk of doing business here. This law requires that to break a contractual relation with its Paraguayan distributor, the foreign company must prove just cause in a Paraguayan court. If the relationship is ended without just cause, the foreign company must pay an indemnity. The rights under this law cannot be waived as part of the contractual relationship between both parties. Foreign companies have paid large sums when ending distributor relationships in Paraguay to avoid lengthy court cases or have maintained relationships with underperforming representatives to avoid such payments.

Decree 11.459/95 requires importers of used clothing to obtain an import permit from the Ministry of Industry and Commerce. Importers must obtain a certification notarized in place of origin showing that the used clothing has been sanitized. In 1999, the Ministry of Industry and Commerce had refused to take action on applications to import used clothing, in effect prohibiting its importation.

Decree 235/98, later modified by decree 2698/99, created a multiplier increasing the base value on imported cigarettes and beer prior to calculating excise tax. The same multiplier was not applied to domestic products. Income tax must be pre-paid on presumed profit margins of ten percent for imported cigarettes and thirty percent for imported beer prior to removal from customs. Local manufacturers of cigarettes and beer pay income taxes only on reported profit margins and at year-end.

#### *7. Export Subsidies Policies*

There are no discriminatory or preferential export policies. Paraguay does not subsidize its exports. However, Paraguay exports 90 percent of its cotton crop, and government-subsidized credit to small-scale producers signifies an indirect export subsidy. Government subsidized financing for the 1997-98 crop was provided to the producers of 80 percent of the cotton harvest. Due to high default rates, subsidized credit for the 1998-99 crop was reduced to cover only 30 percent of production. The government will provide small-scale farmers with subsidized inputs, such as seed and pest control products.

#### *8. Protection of U.S. Intellectual Property*

Paraguay belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO). It is also a signatory to the Paris Convention, Bern Convention, Rome Convention, and the Phonograms Convention. In January 1998, the U.S. Trade Representative designated Paraguay as a "Special 301" Priority Foreign Country. On February 17, 1998, the U.S. Government initiated a 301 investigation of Paraguay as a result of its inadequate enforcement of intellectual property rights, its failure to enact adequate and effective IP legislation, as well as its status as a distribution and assembly center for pirate and counterfeit merchandise and the large illicit re-export trade to other MERCOSUR countries.

On November 17, USTR concluded a bilateral Memorandum of Understanding (MOU) and Enforcement Action Plan that contain specific near-term and longer-term obligations to improve the intellectual property regime in Paraguay. The Agreement contains commitments by Paraguay to take action against known centers of piracy and counterfeiting; pursue amendments to its laws to facilitate effective prosecution of piracy and counterfeiting; coordinate the anti-piracy efforts of its customs, police, prosecutorial, and tax authorities; implement institutional reforms to strengthen enforcement at its borders; and ensure that its government ministries use only authorized software.

As a result of this agreement, the U.S. Government has revoked Paraguay's designation as a Priority Foreign Country and terminated the Special 301 investigation. Implementation of the MOU is being monitored under Section 306 of the U.S. Trade Act.

Patents: Congress is currently considering comprehensive patent legislation. Domestic

industry has lobbied heavily to weaken the law. In its IPR MOU with the U.S., Paraguay agreed to do everything possible to pass TRIPS consistent patent legislation during the first three months of the 1999 legislative session. Paraguay also has patent obligations as a member of the WTO.

**Trademarks:** On August 6, 1998, a new Trademark Law was promulgated that includes a broader definition of trademarks. The law prohibits the registration of a trademark by parties with no legitimate interests. Provisions provide specific protection for well-known trademarks. The law also includes stronger enforcement measures and penalties for infractions. In practical terms, trademark violation is still rampant in Paraguay, and resolution in the courts is slow and non-transparent. The new law provides an important first step, but must be followed by increased enforcement and modernization of the judicial system to become fully effective.

**Copyrights:** On October 15, 1998, then-President Cubas Grau signed a new Copyright Law, which follows international conventions to protect all classes of creative works. Software programs receive the same treatment as literary works under the law. The law contains norms that regulate contracts related to copyrights. Law 1444, passed on June 25, 1999, made copyright violations “public actions,” allowing public prosecutors to take legal action without requiring the offended party to seek redress. Practical application of copyright protection suffers the same systemic challenges as trademark protection.

## 9. *Worker Rights*

In October 1993 the Paraguayan Congress approved a new Labor Code that met International Labor Organization standards.

*a. The Right of Association:* The Constitution allows both private and public sector workers, except the armed forces and police, to form and join unions without government interference. It also protects the right to strike and bans binding arbitration. Strikers and leaders are protected by the Constitution against retribution. Unions are free to maintain contact with regional and international labor organizations.

*b. The Right to Organize and Bargain Collectively:* The law protects collective bargaining. When wages are not set in free negotiations between unions and employers, they are made a condition of individual employment offered to employees. Collective contracts are still the exception rather than the norm in labor/management relations.

*c. Prohibition of Forced or Compulsory Labor:* The law prohibits forced labor. Domestics, children, and foreign workers are not forced to remain in situations amounting to coerced or bonded labor.

*d. Minimum Age for Employment of Children:* Minors from 15 to 18 years of age can be employed only with parental authorization and cannot be employed under dangerous or

unhealthy conditions. Children between 12 and 15 years of age may be employed only in family enterprises, apprenticeships, or in agriculture. The Labor Code prohibits work by children under 12 years of age, and all children are required to attend elementary school. In practice, however, many thousands of children, many under the age of 12, work in urban streets in informal employment.

*e. Acceptable Conditions of Work:* The Labor Code allows for a standard legal work week of 48 hours, 42 hours for night work, with one day of rest. The law also provides for a minimum wage, an annual bonus of one month's salary, and a minimum of six vacation days a year. It also requires overtime payment for hours in excess of the standard. Conditions of safety, hygiene, and comfort are stipulated.

*f. Rights in Sectors with U.S. Investment:* Conditions are generally the same as in other sectors of the economy.

**Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad  
on an Historical Cost Basis -- 1998**

(Millions of U.S. Dollars)

Category	Amount
Petroleum	14
Total Manufacturing	22
Food & Kindred Products	0
Chemicals & Allied Products	0
Primary & Fabricated Metals	0
Industrial Machinery and Equipment	0
Electric & Electronic Equipment	0
Transportation Equipment	0
Other Manufacturing	22
Wholesale Trade	(1)
Banking	(1)
Finance/Insurance/Real Estate	0
Services	0
Other Industries	2
<b>TOTAL ALL INDUSTRIES</b>	<b>204</b>

(1) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.